

Northern Territory Major Energy Users Group:

Submission to Utilities Commission

on

Possible Review of Certain Regulatory Instruments

October 2007

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EXECUTIVE SUMMARY

The Northern Territory Major Energy Users Group (NTMEU) was established to provide input into the reviews being undertaken regarding the electricity supply arrangements in the Northern Territory. As its most basic issue, NTMEU has seen that electricity prices in the Territory are significantly higher than in other Australian States and Territories. This has meant NT consumers suffering a cost disadvantage compared to their competitors outside the Territory and creates a price premium for operating in the NT.

The NTMEU welcomes the opportunity provided by the Utilities Commission to be involved in the Commission's review of its role in the regulatory oversight of the electricity supply in the NT. These changes would necessitate the Commission moving away from its 'light handed' regulatory approach. This move would be consistent with the NTMEU's view that the current monopoly power provider (Power and Water) acts like any other monopoly service provider, and as such, requires closer regulatory oversight and monitoring than would apply in a competitive market environment.

The NTMEU considers that the current regulatory powers granted to the Commission, and the approach used by the Commission in implementing its regime, is more appropriate for use in a more competitive market such as in the Australian National Electricity Market. With a single monopoly provider of a bundled service, the current regime is insufficient to provide adequate oversight over Power and Water to deliver to economically efficient services that were the expected outcomes of the policy arrangements put in place.

Experience in other Australian jurisdictions has demonstrated that it is not effective to try and make a vertically integrated electricity monopoly act as if it were in a competitive market environment by edict, such as by legislative fiat via a high level regulatory regime, as is the case in the Northern Territory. Time and again, the evidence is that a monopoly will use its position of market power to minimise any new entrant competition by "seeing off" a potential new entrant or by "buying into" a new competitor. Either approach keeps the monopoly insulated from competition and as a result, can frustrate the aims of government seeking to introduce competition into the market for an essential service.

The NTMEU suggests that a first order of priority for action is to create a pro-competitive industry structure and market. This would require government policy intervention to

introduce new entrants into the generation and retail sectors, by creating new, legally separate entities from the existing assets. If a transitional phase is required or considered practical, then as a minimum, Power and Water electricity activities should be separated into legal entities of generation (with the potential for all future new generation to be carried out by a different entity), and retail (either by separating the current PW Retailer or introducing a new entrant retailer as the new generation entity is introduced). A new network provider would be created separately, but incorporating system controller and planner functions.

It is noted that the NT Treasury is proposing consultations with consumers with a view to the Government making a final decision in the first half of 2008, to transition to the national energy regime. The structural and policy steps suggested by NTMEU for breaking up the vertically integrated electricity service provider and for creating an environment for the introduction of new generation and retail entrants which is consistent with the major structural elements of the national regime, albeit recognizing that short term transitional arrangements and derogations from provisions of the regime may be necessary.

As an interim step prior to full membership of the national regime, the Commission would need to have the ability to set pricing frameworks for contestable consumers, and the power to arbitrate on pricing at the request of either Power and Water or a contestable consumer. This power would require the Commission to use cost reflective pricing as the basis of its arbitral decisions.

In addition, the Utilities Commission should engender transparency of the various Power and Water contracts and agreements between its own separate businesses and with customers, with a view to ensuring that they are cost reflective, non-discriminatory and are robust, arms-length transactions. Appropriate guidelines would need to be developed and implemented. The Commission should also introduce an effective ring fencing code, together with other necessary guidelines (e.g. on pricing for contestable customers, market conduct and market surveillance, dispute resolution, access agreements, cost allocations, treatment of contestable and non-contestable customers, service standards, etc.).

The NTMEU is prepared to work with the Commission in the processes for implementation of changes and development of new guidelines and Codes.

1. Introduction

The Northern Territory Major Energy Users Group (NTMEU) welcomes the opportunity to provide comments on the Utilities Commissions' Issues Paper on 'Possible Review of Certain Regulatory Instruments'. The NTMEU members are medium to large electricity and gas users and comprise the following companies: Northern Cement Limited, Parmalat Australia, NT Airports, Darwin Central Hotel, Darwin Private Hospital, Natural Fuels, Compass Resources NL, and [Yeperenye Pty. Ltd.](#)

The NTMEU has been established by the larger businesses operating in the Northern Territory. The members of NTMEU cover a range of industries; from manufacturing through to tourism. Members companies have identified that there are potentially more commercial options for providing essential services of electricity (and gas) than currently apply in the Territory, and are prepared to work with the Government and the Utilities Commission to improve the current energy supply arrangements. The NTMEU does recognise the unique nature of the NT (its relatively low population and population density, its large area, and its remoteness from other Australian markets) but it sees that large amounts of gas available nearby and the closeness of northern (overseas) markets can provide a basis for a more competitive Northern Territory energy market, which in turn drive additional downstream investment and expand employment opportunities in the Territory.

NTMEU member companies' main objective is to promote access to long term, sustainable and competitively-priced energy (electricity and gas) supplies in the Northern Territory. We have identified a key interest in the **cost** of energy supplies (commodity, network services and transactions costs) as this represents a significant cost element in each member's business operations.

Although electricity (and gas) is an essential source of energy required by each member company in order to maintain operations, a failure in the supply of electricity (and gas) will cause every business affected to cease production and/or suffer loss. Thus the **reliable supply** of electricity (and gas) is an essential requirement of each member's business operations.

With the introduction of highly sensitive equipment necessary to maintain operations at the highest level of productivity, the **quality** of energy supplies has become increasingly important, with the need for a focus on the performance of the distribution networks. Variation of electricity voltage, especially voltage sags, momentary interruptions and transients (and also of gas pressure) by even small amounts, now has the ability to shut down critical elements of many production and/or service processes.

Each of the businesses represented in the NTMEU has invested considerable capital in establishing their operations and in order that they can recover the capital costs invested, long-term **sustainability** of energy supplies is paramount. If sustainable supplies of energy are not available into the future, investments made by energy users quickly lose their value.

Accordingly, the NTMEU has a keen interest in addressing issues that impact on the **cost, reliability, quality**, and the long term **sustainability** of member companies' electricity (and gas) supplies.

The NTMEU recognises that particularly electricity supplies (but also gas supplies to a lesser extent) are an essential service. There is no element of today's modern society that does not rely on electricity, whether it is for motive power or for lighting. The alternatives to using electricity for these needs are universally environmentally unacceptable, less safe or commercially less viable. The NTMEU does not accept the contention made by some that there are alternatives to using electricity to manage the demand for electricity supplies. This means that, by and large, the electricity supply has to match the needs of consumers, rather than consumers modifying their power usage for the benefit of the electricity supply arrangements, although where electricity consumption can provide assistance in achieving the goals of consumers (in cost, reliability, quality and sustainability), fair value must be given to those consumers who can and do modify their usage to provide a benefit.

The NTMEU has identified that compared to equivalent operations in rest of Australia, the cost of energy in the NT is significantly higher and this creates a barrier to entry of new downstream investment, especially for manufacturing activities. As such, it minimises the potential for NT based industry to export to other parts of the country (or overseas), or to develop competitive import replacement opportunities, as the comparative energy prices clearly favour importation to self manufacture.

Equally, the NT has the potential to be a destination for tourism but the high comparative energy prices make costs for visiting the NT an expensive option compared to locations elsewhere which are of equivalent attraction, but lower cost, due to the energy supply advantages.

The NTMEU takes the view that the current issues surrounding energy supplies in the Territory are not unique and have been addressed by other Australian governments and in overseas jurisdictions. Accordingly, the NTMEU has sought advice from consumer advocates experienced in energy matters, who have been involved, as advisors, in the transition from vertically integrated monopolies to markets driven by competition in the Australian context. They have also provided insights into how overseas jurisdictions have transitioned from monopoly to market driven solutions for provision of energy supplies.

The over-riding requirement is to create a competitive electricity market, beginning with the establishment of a pro-competitive electricity industry market structure and a regulatory regime to drive economically efficient outcomes.

2. A Competitive Electricity Industry Structure

The NTMEU's vision for the Northern Territory's electricity industry is for the creation of a competitive electricity industry structure in the Northern Territory, as competition is considered to be the best driver for economically efficient outcomes. The NTMEU considers that although economies of scale can lead to lower energy prices, the current approach to having a vertically integrated (generation, network services and retail) monopoly provider for energy supplies has been shown to be less economically efficient than having some competition introduced into the monopoly market. Experience from the Australian NEM and other energy markets overseas, has shown that even corporatising assets such as generators supported by the introduction of a degree of competition, has led to improved supply availability and more efficient plant operation. Where such a mix includes privately owned generation, the improvements are even greater, as prices decline and service performance improves. A viable and economically efficient industry also leads to the sustainability of the industry and provides for adequate future capacity.

Accordingly, the NTMEU sees that a competitive electricity industry structure for the Northern Territory should be based on:-

- separation of the transmission and distribution network from the existing generator as network services are really a monopoly service but generation can be contestable (with the system control and the operation of the network sensibly managed by the network operator for small energy systems, as applied in Tasmania for a number of years);
- separation of the distribution network from the existing retailer allowing new retailers to enter the market thereby creating contestability;
- establishing the ability for competition between the existing and new generators and retailers;
- establishing appropriate rules for power purchase and wholesale market transactions suitable for all participants, large and small; and
- establishing a customer market for consumers deemed to be contestable.

Competition is inevitably about choices. For electricity customers (retailer or end user) the most important feature of a competitive electricity market, is to have access to alternative options for electricity procurement for the forecast demand (a mix of base, intermediate and

peaking supply) and to be able to trade contracted power supplies to manage the inevitable swings of demand (the “unders and overs”) that are an outcome of the actual usage of electricity (and gas).

This is achieved by ensuring that there is:-

- the right to own and operate power stations or shares of power stations;
- the right to buy power from different generators or suppliers within the interconnected network;
- the right to have access to the network, and the right to transmit, on a non-discriminatory basis; and
- the right to decide how this capacity is to be utilised.

Against the above background, the NTMEU notes that the Northern Territory’s electricity industry structure provides for the issuing of separate licences as follows:-

- generation: the right to produce and generate electricity;
- networks: the right to operate the network system within a specified geographical area; and
- retail: the right to trade in electricity and to sell electricity to final customers.

However, there is currently only **a single vertically integrated company** – Power and Water Corporation – which holds the licences to operate the largest generators, to be the network service provider and be the single energy retailer in the Northern Territory.

In addition, the monopoly network service provider is required to provide negotiated access agreements (consistent with the network access code) with intending new entrant generators. The network service provider is expected to operate as an “honest broker” with proper rules for third party access to the grid. However, the concept behind the network service provider as a pro-competitive “honest broker” is somewhat negated, in the absence of certain modes of behaviour that are engendered by structural separation of the businesses in the Territory, including the operation of an effective Ring-fencing Code.

A Utilities Commission has also been established to:

- license participants in the electricity industry;
- monitor and enforce compliance with the licensing regime.

When introducing the Electricity Reform Bill 1999¹ (which came into effect on 1 April 2000) the objective of the then Government was for all licences issued to require industry participants to:

- comply with certain technical codes, dealing with technical and service delivery requirement (such as those relating to metering, connection to networks, system control and security);
- ring fence their monopoly activities from their “contestable” activities, with requirements for separate accounting and information systems, and precluding cross-subsidisation between monopoly networks;
- pricing orders setting the prices at which electricity is sold to non-contestable customers;
- for contestable commercial customers, maximum permitted year to year movement in average prices are set by government, with tariffs structured in an equitable and cost-reflective manner; and
- the Utilities Commission to approve PAWA’s proposed tariff structures within the revenue caps set by government, (whose pricing orders may establish side-constraints on the extent of tariff re-balancing).

Furthermore, under the regulatory framework established by the Bill, an access code was to oblige network providers:

- to reasonably accommodate the requirements of those seeking access to the electricity network;
- to provide access on a non-discriminatory basis between various network users and potential users; and
- ring-fencing of PAWA networks from the rest of PAWA, with separate accounts and records.

¹ Electricity Reform Bill 1999 Northern Territory Second Reading Speech

Regulation of access prices was to involve:-

- setting an annual cap or limit on the network provider's total revenue;
- overseeing the network provider's setting of 'reference' (or maximum) tariffs for network use;
- overseeing the network provider's setting of capital contributions; and
- overseeing PWA generation's setting of prices charged for out of balance energy.

Price regulation was introduced to achieve:-

- reasonable certainty and consistency over time;
- acceptable balancing of the interests of network providers, network users and the public;
- an environment, which fosters efficient operating and maintenance practices within the network sector, the efficient use of existing infrastructure and an efficient level of investment within the network itself; and
- promotion of competition in upstream and downstream markets.

The independent Utilities Commission was established with the powers and functions to:-

- promote competitive and fair market conduct;
- prevent the misuse of monopoly or market power;
- facilitate entry into relevant markets;
- promote economic efficiency;
- ensure customers benefit from competition and efficiency;
- protect the interests of consumers with respect to reliability, quality and safety of services and supply;
- facilitate the maintenance of the financial viability of the industry; and
- ensure an appropriate return on public sector assets.

The NTMEU agrees, in principle, with the above broad market structure and regulatory framework established under the Electricity Reform Act in the Northern Territory, as they move in the direction of the NTMEU's vision for the industry and market. However, it is noted that the policy framework has had little real impact in achieving competitive

outcomes for electricity consumers in the Northern Territory and the outlook does not appear promising, in the light of current and future developments, especially the continuation of the role of the dominant supplier, Power and Water.

It is worth noting that in general any dominant supplier can frustrate competitive pressure and the entry of new players by adopting anti-competitive rules for access and pricing. It can also extract economic rents across the whole vertically integrated business. This “dominant supplier factor” has been ably described by the World Bank² as:-

*“Of particular concern will be the role of the dominant supplier. In almost all cases, the development of competitive alternatives will take time and new suppliers in the market will be small relative to the existing monopoly. The monopoly, through its **power purchase arrangements and its day to day operations** is usually in a position to determine the commercial success of any potential competitor.....*

It will be essential for the Government to establish, through the regulatory process, a credible arms-length relationship with this dominant supplier”

In this regard the NTMEU would point to the activities of Western Power Corporation, which was the single integrated power provider in WA. The relationship between Western Power Corporation, the WA government and consumers is well documented, but until Western Power Corporation was disaggregated into the separate elements recommended above for Power and Water, despite ring fencing rules, there was a clear outcome that most new generation options either did not proceed due to Western Power Corporation offering better outcomes to proponents or were developed with Western Power Corporation involvement.

There is clearly much that needs to be done at the policy level to create a competitive electricity market in the Northern Territory. Simply adhering to or joining the National Electricity Market, will be a necessary step but it will be insufficient, as much specific policy actions (other than transitional issues) are needed. By way of a major example, the NTMEU points to the critical issue of generation monopoly.

² A.A. Churchill, World Bank, Paper delivered to the Asean Energy Conference, Singapore June 1992

The absence of competition in electricity generation in the Northern Territory will be exacerbated when the new Black Tip field gas processing plant comes on line in 2009. There is currently an agreement between Power and Water and Woodside (operator of the gas field) for the delivery of new gas to augment the generation capacity of Power and Water. It would be expected, *ceteris paribus*, that having a source of lower cost gas compared with the current supply from the south of the Territory (Palm Valley and Mereenie) the cost of electric power should fall. Certainly, if this new gas is blended with regard to price with the last of the southern supply, then for reasons of increasing competition, there is a sound case for the NT Government to require Power and Water to allocate new gas supplies to a competitor generator rather than to the existing PW Generator.

However, if a new entrant is required to source gas in its own right, then they will face negotiating additional gas supplies in their own right with Conoco Philips (with its existing onshore LNG export facility) or Woodside. This will be a poor negotiation position and allows PW Generator to retain its role as pre-eminent generator, and potentially reducing new entrant competition.

The NTMEU notes that the NT Treasury is planning consultations with NT energy users in the near future regarding the Government's policy developments and will actively participate in these consultations. It is sufficient, for now, to state emphatically that policy and structural changes are needed to create a competitive electricity market in the Northern Territory. The issues raised by the Utilities Commission are also critical and the NTMEU support the initiative to discuss and debate these issues. The first order priority is to get the policy and structure right.

Nevertheless, the "devil is in the detail" of implementation, and the NTMEU proposes to devote its available resources to working with the Government, the Utilities Commission, the electricity supply industry and other participants to ensure that the Northern Territory's electricity market is consistent with world's best practice outcomes. Such outcomes will enable NTMEU members to sustain existing and make new investments, and create additional job opportunities in the Territory.

3. Issues Raised by the Utilities Commission

The Utilities commission's Issues Paper raises three broad issues for stakeholder comment:

1. Is there any disagreement with the Commission's views regarding the nature and extent of current regulatory deficiencies and their implications for the Commission? If so, why?
2. Is there any disagreement with the Commission's views regarding the nature and extent of prospective policy developments and their implications for the Commission? If so, why?
3. Is there any disagreement with the Commission's proposal to undertake a major review of the NT electricity ring-fencing code and to develop certain contestable pricing guidelines? If so, why?

Each of the Utilities Commission's major issues is examined in the following section. The Commission's description of the factors surrounding the issues raised in the Issues Paper is briefly noted, followed by comments from the NTMEU.

4. Current Regulatory Deficiencies

Notwithstanding the legislative and regulatory frameworks and arrangements that have been put into place under the Northern Territory's 1 April 2000 legislative package, the Utilities Commission has stated that a number of deficiencies in the current arrangements exist. These are described in the Issues Paper and are briefly covered below:

4.1 System Planning and Control

Under current arrangements, a number of important system control and market administration functions remain within the sole supplier (Power and Water) and formal procedures for managing the level of reserve capacity – plus the critical issue of how investment in new capacity is determined – are absent. For example:-

- the responsibilities, accountabilities and powers of the main participants with regard to **system planning, Power and Water Generation, Power and Water Networks,** and the **Utilities Commission** are largely undefined.
- there is limited recognition regarding the desirability of separating public interest responsibilities from commercial interests.

There are also concerns regarding the operation, planning and reliability of the Northern Territory power system, as well as the impact on competition.

4.2 Retail Market and Customer Protection

Power and Water is a vertically-integrated monopoly utility, as it is the NT's only generator and retailer. Competition has not developed since the April 2000 legislative package. Customers are, therefore, exposed to Power and Water's market power. The realities of the situation are quite distinct from the intent of the Territory's legislative and regulatory policy package.

4.3 Generation Barriers to Entry

The commission's Issues Paper has identified the following:-

- the availability of a new long-term gas contract by Power and Water, with exclusive rights to the available gas

- commitment by Power and Water of a new power station adding 35 MW of capacity to the Darwin Katherine System in 2007/08 and again in 2010/11
- sufficient capacity to maintain reserves in excess of N-1 through to 2015/16.

Against the above background, any new generator will face enormous challenges, both market based and systems based.

4.4 Retail Barrier to Entry

According to the Utilities Commission's Issues Paper, there are currently no publicly observable de facto contracts or service level agreements in place between Power and Water's generation and retail arms defining Retail's terms of purchasing of wholesale energy from generation.

If a new retailer were to seek entry into the NT's electricity market, or if a large contestable customer wants to directly source wholesale power, they face the following hurdles:-

1. An understanding the exact nature of the bilateral contracting framework currently in place
2. That there really is equality of regulatory treatment afforded to them via-a-vis Power and Water
3. Confidence that ring-fencing processes in place are effective to ensure there is competitive neutrality.

The NTMEU is concerned with the extent and significance of the existing regulatory deficiencies identified by the Issues Paper, noting that many key critical deficiencies can only be addressed at the policy level and unless they are reformed, the issues proposed by the Utilities Commission for rectification (within the existing framework) will have less than effective impacts on the electricity market and on efficient outcomes for consumers.

Firstly, system planning, reliability, generation reserves, lost factors and adequacy of new generation capacity are critical for the long-term sustainability of energy supplies in the Northern Territory and for the continued viability of NTMEU members' investments. In many of these areas, it is clear that an independent agency would need to be responsible for ensuring these critical elements are provided (rather than by Power and Water) and ensuring that greater transparency of the detailed implementation arrangements is implemented.

Secondly, it is most important to separate public interest responsibilities from commercial interest because of their impact on competition and competitive outcomes for consumers. All businesses (whether they are monopoly providers or operating in a competitive environment, private or government owned) must be expected to focus on maximising revenues and profits as this is the measure their investors use to identify the effectiveness of the operation. To achieve this outcome a business will ration demand up to the point which prevents a new entrant from entering the market. Consumer interests are not the paramount objective of a business except to the extent that by dint of its operations it causes its customers to seek alternatives.

In particular, a monopoly provider will act in any way it can to prevent the emergence of competition, as it sees that competition will reduce its ability to deliver the best commercial outcome to its owner(s).

A Government is not the most appropriate owner of a business delivering monopoly services to the community as a government has competing goals – to get the best return (in terms of efficiency, cash or other benchmark set for performance of the entity) from its business but, at the same time, to deliver the most economical services to the community it serves. Although government ownership might be necessary, to ensure that its owned entity operates most effectively requires vibrant and competent competition to ensure that the government owned business is operating at its most effective. This then allows the government to concentrate not on ensuring performance of its owned business, but on providing the services the community it serves in terms of the obligations it considers necessary and appropriate.

The NTMEU sees that it is not just the appearance that competition is possible in the market, but that a new entrant can operate on equal terms without having to deal with its prime competitor in order to enter the market. The emergence of competition relies just as much on the appearance of competition being possible as it does on the reality that there is a competitive environment which will allow the new entrant a “level playing field”.

Accordingly, the NTMEU supports the identification of the specific regulatory deficiencies in the Issues Paper. These – barriers to generation and retail competition, the continued

existence of the sole vertically integrated electricity business, the control over system planning and control by Power and Water – need to be addressed at the policy level.

5. Prospective Policy Developments

5.1 Prospects for regulatory change

According to the Utilities Commission's Issues Paper the Northern Territory Government has been reviewing the effectiveness of the existing electricity market regulatory regime and is considering the merits of joining the national energy regime established by the Australian Energy Market Agreement. There is, apparently, a very real possibility that regulatory jurisdiction for the NT electricity market will migrate to the national arrangements after mid-2008. There is also recognition that modifications to the national regime are likely (perhaps even necessary) in order to meet Territory-specific circumstances.

Against that background, the Commission believes that addressing the following areas seems most likely to be overtaken by the Governments proposed policy reform:-

- ⇒ third party access to networks and associated access price regulation;
- ⇒ Power and Water's de facto responsibility for power system planning and reliability; and
- ⇒ system control issues.

The areas that could be addressed by the Commission (at least in the short term, as they seem unlikely to be overtaken by the NT's migration to the national electricity regime, include:-

1. Barriers to entry directly associated with Power and Water's vertical integration in general, and the lack of legal separation between Power and Water's networks, generation and retail businesses and between its franchise and contestable retail businesses in particular; and
2. The lack of regulatory oversight in the 'contestable' market segments in the absence of any alternative supplier to Power and Water.

The NTMEU agrees with the Commission in that there will need to be NT-specific transitional issues that are unlikely to be dealt with by likely changes in the regulatory policy environment (simply by joining the National Electricity Market) or will need to continue in place for a time. That being said the NTMEU agrees with the Commission that

it cannot continue to defer the exercise of its existing powers in such areas on grounds that the NT will soon be joining the national regulatory regime. It is noted that the Commission has, hitherto, adopted a 'light handed' regulatory approach, which in NTMEU's view, is inappropriate given the lack of a competitive industry structure and market.

The NTMEU strongly believes that the key issue concerning the vertically-integrated nature of Power and Water's three businesses of generation, network service provider, and retailer, must be addressed sooner rather than later. In effect, the three businesses should be **legally** separated, with the network service provider **physically** separated as well, but having the system planning and operation retained within the network business.

This will effectively create a monopoly business integrating network ownership, with system operation and planning as a separate entity, and allowing the generation and retail functions to operate independently on commercial grounds.

Accounting separation is not only necessary but essential with accounting principles introduced to deal with key issues such as cost allocations between the regulated network and system operation functions and notionally unregulated retail and generation activities. There will also be a need to have provision to enable the Commission to pierce any corporate veils in order to establish that related party or other transactions are established at arms-length. Transparency is critical. An effective compliance regime, including specific provisions to engender behaviour changes, are also necessary.

When competition is not present, regulation is a surrogate for competition until competition has emerged and is viable. This means that regulatory oversight over the contestable segments of the industry (generation and retail) becomes critical, in the absence of alternative suppliers to the Power and Water sources. Depending on the policy decision on issues such as whether to introduce measures to encourage new entrants (e.g. reserving new market shares to new entrants or limiting Power and Water from building new assets), it will be necessary to have regulatory oversight over maximum tariffs and service standards. In this regard, greater transparency of the contestable segments is required. This might include price, service, reliability and other performance information that could be suitably benchmarked against Australian and World Best Practice.

The relationships between the functions of generation and retail within the Power and Water structure will need to be clearly demarked, and prices offered by PW Generation to PW Retail need to be transparent and subject to Commission review. A failure to implement such transparency and oversight can enable Power and Water to prevent access of new entrants because of the concern of the apparent ability of PW Generator and PW Retailer to collude to prevent new entrants.

6. Commission's Preferred Approach

The Commission's capacity to address the NT specific regulatory deficiencies depends not only on its existing powers and functions, but more importantly, dependent on the policy decisions that are to be taken with respect to the government's approach to transitional issues, the duration they will remain, sunset arrangements, and so on.

The NTMEU notes that the Commission is also constrained to a degree by the government decisions with regard to prices. In part, some benefits are provided directly to certain classes of consumers (ie CSOs) through Power and Water, and in other areas there are constraints imposed on the pricing regime. Ultimately, Power and Water is empowered to use the funds provided as CSOs and to allocate its costs to meet government directives.

In a competitive environment the pricing regime reflects the costs involved with providing the service (ie that the more of the assets used in providing the service, the higher the cost). The NTMEU has noted that the current pricing regime of Power and Water does not follow these precepts, probably as a direct result of government directives. Regardless of the reasons, the outcome does not reflect economic principles that are fundamental to competition.

6.1 Ring-fencing Powers

Notwithstanding the above comments, the NTMEU agrees with the Commission's proposal to review the NT's Ring-Fencing Code. In this regard, whilst we note that the NT's Code replicates codes in place in other jurisdictions, the issue of "separate operation" versus "legal separation" needs to be more fully explored, within the constraints of the policy environment.

The NTMEU considers that there should be legal separation of the three businesses of generation, network services and retail. Depending on the Government's **policy decisions** on this issue, it would, nevertheless, be necessary for a review of ring-fencing to be undertaken by the Commission. The details and the provisions contained in the Code would need to reflect the decisions taken at the policy level for legal separation and other structural decisions.

6.2 Guideline-making Powers

The NTMEU notes that guidelines have been issued by the Commission in relation to:-

- Framework for Negotiation of Discounted Network Tariffs
- Negotiation of Power Prices with a Large New Load
- Standards of Service Code Procedural Guidelines

In particular, the NTMEU notes that Section 48(1)(b) of the Electricity Reform Act authorises the Commission to conduct investigations into conduct that may be contrary to the competition and efficiency objects of the Electricity Reform Act and the Utilities Commission Act. Guidelines such as these are useful as they inform the market, and can assist with the better functioning of a competitive market. Unfortunately, Power and Water is not apparently bound to comply with the outcome of any such investigation, and as it is still the monopoly provider, it can retain its initial position regardless of any negotiation undertaken.

Notwithstanding the presence of negotiating frameworks for power prices and network access tariffs, the NTMEU would note that “negotiating” with a monopoly is an oxymoron. Experience of NTMEU members replicates the experiences of other consumer “negotiations” with monopolies in other jurisdictions. These experiences show that the outcomes of such “negotiations” are inevitably in favour of Power and Water due to a lack of any alternative for the consumer. Even where it has been clearly demonstrated that the Power and Water determination is clearly not a result of cost reflectivity, the outcome effectively remains the same.

PW Retail uses the current notional separation of retail and generation in its negotiating approach so that it is always “the other” party that causes any lack of negotiating movement. PW Generation is accused of not negotiating but there is no ability for a consumer to address issues directly with PW Generation. As PW Generation is a monopoly generator there is no reason for it to negotiate and it is able to “hide behind” PW Retailer.

Because of this it is suggested that the Commission should seek powers to allow it to be involved in such negotiations (as a dispute resolution body) so that it can provide an independent assessment of the issues and if needed to act as an arbitrator. Pending an

increase in competition, the NTMEU sees that the current frameworks established by the Commission have little ability to enforce a reasonable outcome for consumers.

Therefore, because of the lack of any alternative supplier for a foreseeable period in the Northern Territory, it is essential that the Commission develops contestable pricing guidelines. The NTMEU agrees that generation and retail pricing guidelines are needed and that they include requirements in regard to pass through of network service costs and establishment of generation prices based on cost reflectivity.

Conclusion and Recommendation

NTMEU members have noted that effectively Power and Water operates as a “**cost plus**” enterprise. Negotiations with Power and Water have effectively resulted in statements being made that “if we give here, then we need to take from there” (i.e. economic rents can be extracted across the vertically integrated business chain). Operating on a cost plus basis provides no driver on a monopoly for it to reduce its costs or to be more efficient. It is competition that drives efficiency and the NTMEU sees that a truly competitive environment is the basic requirement.

It is also noted that Power and Water does not follow a **cost reflective** approach to providing the monopoly service, and in part this is caused by Government Directives.

The Utilities Commission should be congratulated for taking the initiative with the issuing of its Issues Paper to discuss the further, urgent steps necessary to develop a more competitive electricity industry in the Northern Territory.

Policy action is clearly critical and is a first order priority. The Northern Territory must act to develop a more competitive market structure for its electricity industry. Actions must include legal separation and the break-up of the vertically integrated Power and Water. A disaggregation of power generation assets owned by Power and Water in the NT should also be implemented.

Introduction of new generation could either be from a new entrant or allocated to a new (separate) generation entity of Power and Water specifically created to engender competition. Likewise, the PW Retailer could be split into two competing businesses, or an existing retailer encouraged to enter the NT market, perhaps on a tender basis.

The network business and system operation and control functions should be legally separated from the other Power and Water activities.

As an interim measure, the Commission should have the power to be involved in price negotiations and to set generation prices that are reflective of the cost of the services being provided.

Moreover, the NTMEU agrees and supports the Utilities Commission in its view on the introduction of the various Codes and Guidelines identified in the Issues paper. The Commission needs to desist from its 'light handed' regulatory approach and adopt a regulatory stance which is consistent with the existing non-competitive electricity structure and market, bearing in mind the need to balance the potential benefits with the potential costs.

Finally, the Utilities Commission should engender transparency of the various Power and Water contracts and agreements with its own separate businesses and with customers, with a view to ensuring that they are cost reflective, non-discriminatory and are robust, arms-length transactions. Appropriate guidelines would then need to be put into place. The Commission should also introduce an effective ring fencing code, together with other necessary guidelines (e.g. on pricing for contestable customers, market conduct and market surveillance, dispute resolution, access agreements, cost allocations, treatment of contestable and non-contestable customers, service standards, etc.).

The NTMEU is prepared to assist the Commission in implementation of the changes planned and development of the guidelines and Codes identified as being needed.